IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-119

SOPHIE RUSKAY, LOUIS FELDMAN, Trustee etc., WEBSTER FACTORS, INC., and IRWIN L. FEINBERG, as Trustee etc.,

Petitioners,

versus

CHAUNCEY L. WADDELL, JOE JACK MERRIMAN, CORNELIUS ROACH, MITCHELL J. VALICENTI, WADDELL & REED, INC. (a New York corporation), WADDELL & REED, INC. (a Massachusetts corporation), and UNITED FUNDS, INC.,

Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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1. The general release.

Respondents nowhere dispute that the practice of including a general release in derivative settlements raises grave constitutional and statutory questions, calling urgently for review by this Court. Respondents do contend—and that is the beginning and end of their argument (Br. 10-12, 18-19)—that the present case involves no general release.

The Court below, however, referred, not less than ten times, to the release at bar as a "general release" (Pet. 5a, 6a, 10a, 12a), as something that "is, on its face, a general release" (Pet. 10a). Judge Lasker's order and judgment approving the Horenstein-Ruskay settlement likewise referred to the release as a "general release" (S. App. 32a). Incredibly, Respondents simply ignore these authentic characterizations.

Respondents contend (Br. 11) that the release was not "general" because it did not discharge all possible claims

against them. The argument is just a play on words.* The settlement was not limited to the specific claims actually pleaded, but comprised *generically* all claims "which might have been asserted on the basis of the matters and transactions alleged" in the Horenstein-Ruskay actions (S.App. 21a); or, in the broad language of the release itself, "any and all claims • • • for or by reason of any of the matters or transactions recited or described in the complaints" (Pet. 5a). This generalized language was calculated to expunge all claims, pleaded or unpleaded, known or unknown, if they arose from any "matter" however casually "recited or described" in the complaint.

The Court below, adopting this interpretation, held that the release at bar was broad enough to extinguish the sale-of-office claim, even though the Court expressly refused to find that the claim had been pleaded by Horenstein-Ruskay (Pet. 10a, n. 11), and even though the possibility of such a claim might have been unknown to the Horenstein-Ruskay parties (Pet. 10a, n. 10).** The release was thus a "general release" not just in form, but was fraught with all the evils of a general release that forms part of a derivative settlement: the sweeping destruction of unpleaded claims through judicial action upon the consent of an unrepresentative plaintiff, without judicial evaluation of the probable merits of the claims, and without adequate notice to the stockholders at large. Each of these evils infected the Horenstein-Ruskay general release.

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* A release discharging "any and all claims which I now have or may hereafter have against [the defendant] on account of [a particular incident]" has been held to be a "general release"; *Inter Insurance Exchange* v. *Andersen*, 331 Ill. App. 250, 256-57, 73 N.E. 2d 12 (1947).

** Respondents' assertion (Br. 19) that "The release in question was limited to pleaded claims" flies in the face of the decision below, of the plain language of the release, and of Respondents' own contention (Br. 8) that the "deciding factor" of the settlement was "the disposition of *all* derivative claims which *might be asserted*" for the proceeds of the Waddell & Reed stock sale (emphasis added).

2. Lack of adequate representation.

Respondents falsely insinuate to us the absurd contention that Horenstein-Ruskay were inadequate representatives just because the amount of the settlement should have been greater (Resp. Br. 16-17). We do say that Horenstein-Ruskay could not represent the shareholders of United with respect to the sale-of-office claim because they did not plead that claim and because, moreover, their settlement brief disavowed their supplemental complaints, the only complaints mentioning the Waddell & Reed stock sale (Pet. 4, 11-12).* Horenstein-Ruskay thus did not "insure the vigorous prosecution" of the sale-of-office claim, an indispensable prerequisite of adequate representation.** Horenstein-Ruskay were, therefore, unable to dispose of that claim through a general release. The same constitutional weakness inheres in every general release that is inserted in a derivative settlement with a view to destroying a broad range of unpleaded claims.

3. Lack of judicial evaluation.

It is elementary that, in approving a derivative settlement, the district court must evaluate the strength of the

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*The disavowal was not, as Respondents suggest (Br. p. 13, n. 14), limited to the prayer for an injunction but stated broadly that "The issue raised by the supplemental complaint has become moot and is not a factor to be considered by the Court in passing upon the proposed settlement" (Pet. 41a).

** Contrary to Respondents' assertion (Br. 16-17), findings of inadequate representation are not limited to the instances they mention. In *Gonzales* v. *Cassidy*, 474 F. 2d 67, 74 (5th Cir. 1973), a class plaintiff was held inadequate because he had failed to appeal a decision favorable to him but adverse to the class. In *Papilsky* v. *Berndt*, 466 F. 2d 251, 259-60 (2d Cir.), *cert. denied*, 409 U.S. 1077 (1972), the derivative plaintiffs were held inadequate because they had failed to answer interrogatories. In both cases, the adverse judgments were held to be open to collateral attack in actions brought by other stockholders or class members.

claims to be discharged and balance them against the benefits of the settlement (Pet. 3, 9-10).* Judge Lasker's careful and detailed settlement decision (Pet. 42a-47a) did not so much as mention the sale-of-office claim, let alone give consideration to its strength or weakness. Respondents' unsupported contention that Judge Lasker, nevertheless, considered the claim *sub silentio* is flatly contradicted by the Judge's estimate that the total claims submitted to him for settlement were about $2,000,000 (Pet. 46a). Plainly, the thought that the settlement was to discharge a $62 million sale-of-office claim never entered Judge Lasker's mind. To invest his decision with such an unintended and unanticipated effect would be a perversion of the judicial function and the very antithesis of due process.

We never contended, as Respondents say (Br. 10-11), that Judge Lasker was kept unaware of the supplemental complaints or of their reference to the Waddell & Reed stock sale; on the contrary, we quoted the part of the Horenstein-Ruskay settlement brief specifically discussing the supplemental complaints (Pet. 8, 9, 40a-41a). However, nothing in the supplemental complaints warned Judge Lasker of the existence or possibility of a sale-of-office claim; the facts essential to such a claim were not alleged (Pet. p. 8 n.).

What the Horenstein-Ruskay supplemental complaints did allege was that part of the $80 sales price to be paid for each share of Waddell & Reed stock was an outgrowth and, in effect, a capitalization of Waddell & Reed's illegal brokerage profits and should, therefore, be impressed with

* Respondents (Br. p. 13, n. 16) call this tentative judicial evaluation "a rehearsal of the decision" and consider it "absurd", but the authorities, ignored by Respondents, unanimously require it (Pet. 3-4). Needless to say, the evaluation, since it is only tentative and for settlement purposes, does not necessitate the expansion of the settlement hearing into a full-fledged trial.

a constructive trust for United. Everyone concerned so understood the supplemental complaints, including the Court below* and Respondents themselves. Their settlement affidavit summarized the supplemental complaints as alleging that the $80 sales price for the Waddell & Reed stock—

> "reflected, in effect, a self-serving capitalization of the improper and illegal profits being earned by KCSC [the brokerage subsidiary of W&R] as a result of the matters and transactions previously [i.e., in the principal complaints] alleged." (S.App. 31a)

The supplemental complaints thus alleged no claim independent of the brokerage abuses, such as a sale-of-office claim, but merely sought an additional form of relief for the alleged brokerage abuses, namely, a constructive trust on the W&R shares. The citation, in Respondents' settlement brief, of *SEC* v. *Insurance Securities, Inc.*, 254 F. 2d 642 (9th Cir.), *cert. denied*, 358 U.S. 823 (1958), was, in its context, merely designed to show that Waddell & Reed's alleged misconduct gave United no proprietary interest in the shares of Waddell & Reed (S.App. 26a).

* Thus the Second Circuit's opinion below summarized the supplemental complaints as follows (Pet. 3a-4a):

> "With that development [the announcement of the W&R stock sale], the theory of the [Horenstein-Ruskay] action was changed by amending the complaint to allege that the price paid by CIC for W&R stock represented, in part, the profits realized from the breaches of fiduciary obligations set forth in the original complaints. The actions now sought recovery from W&R on a theory of constructive trust."

The same view of the supplemental complaints was taken by Judge Metzner in the case at bar (Pet. 30a); by Judge Tyler in his decision permitting the filing of the Horenstein-Ruskay supplemental complaints, *Horenstein* v. *Waddell & Reed*, 13 FRServ 2d 330, 332 (S.D.N.Y. 1969); by the Horenstein-Ruskay plaintiffs (Pet. 40a); and indeed by Respondents themselves (S.App. 26a, 31a).

Judge Lasker's attention thus was never directed to the $62 million sale-of-office claim; he was not told that such a claim was to be extinguished by the settlement; he did not mention the claim; demonstrably he gave no consideration to its merits or to the fairness of discharging it for a mere $650,000 payment. The general release thus cannot, as Respondents suggest (Br. p. 14), be sustained as an exercise of Judge Lasker's discretion. Under elementary principles of due process, he was without power to issue a blanket authorization for the general release of unpleaded, unknown and unevaluated claims.

Contrary to Respondents' assertion (Br. 18), *Girsh* v. *Jepson,* 521 F. 2d 153, 159 (3d Cir. 1975), plainly held that a district court, in passing on a derivative settlement, cannot give approval to the release of an unpleaded claim without developing the probable merits of the claim and the fairness of the consideration for surrendering it. By contrast, the decision below sustained just such a judicial approval. The conflict between the Second and Third Circuits should, we submit, be resolved by this Court.

4. Lack of adequate notice to stockholders.

In *Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156, 173 (1974), this Court went to great pains in stressing the importance of individual notice to class members or stockholders. But any notice, however individualized, is useless, and fails to perform its constitutional and statutory function, if it is uninformative or misleading. An inadequate notice "may be as fatal to due process as no notice at all"; *Greenfield* v. *Villager Industries,* 483 F. 2d 824, 834 (3d Cir. 1973).

Since the Horenstein-Ruskay settlement notice (Pet. 35a) undertook to describe the supplemental complaints (Pet. 12, 37a), it was required to do so with reasonable

accuracy. Its phrasing not only failed to suggest the possibility of a sale-of-office claim but actually negated it.*

Respondents say (Br. 14-15) that a settlement notice need not set forth facts and theories "in meticulous detail"; but the proposed extinguishment of a $62 million claim is rather more than a "detail" and should have rated at least a few lines of text in the notice. Respondents' suggestion (Br. 15-16) that the stockholders of United, more than 500,000 in number (Pet. 28a), should have descended on the Courthouse to inspect the pleadings and other records is, of course, wildly impractical; moreover, the records, far from disclosing the proposed release of a $62 million sale-of-office claim, would at most have informed the stockholders that the supplemental complaints had become moot (Pet. 41a).

The purpose of a settlement notice is not to serve as an empty ceremonial. It must inform the stockholders of the nature of the claims to be settled; for otherwise it is impossible for them to make even a preliminary evaluation of the fairness of the settlement or to decide whether they should engage in a further investigation and possibly to oppose the settlement. FRCP 23.1 is designed to provide against the danger of the loss of class rights. The right of the stockholders to object implies the right to know what is being given away—which of the rights of the class. Due

* According to the notice, the only vice of the Waddell & Reed stock sale was that the $80 price was largely attributable to Waddell & Reed's illegal brokerage profits. The notice further stated that the only relief sought by the supplemental complaints was an injunction against the sale or sequestration of the sales proceeds (Pet. 37a). This description precluded any thought that the supplemental complaints asserted a claim, wholly independent of the alleged brokerage abuses, for the sale of office, or that they sought the actual recovery, rather than just the sequestration, of a large part of the sales price.

process requires no less than that. The Horenstein-Ruskay notice fell short of that minimal requirement.*

For all the foregoing reasons, the petition for a writ of certiorari should be granted.

Dated: October 10, 1977.

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* The Court below erroneously assumed that, if the sale-of-office claim was actually pleaded, all parties agreed that the release barred the present action (Pet. 12a). We agreed to nothing of the sort. To the contrary, our appeal brief below (pp. 38, 45-46) expressly argued that, no matter how broadly the pleadings and the release be construed, the inadequacy of the settlement notice would invalidate any release of the sale-of-office claim.